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by various contributors / par divers collaborateurs

Perspective - A quarterly analysis of the financial performance of Canada's P&C insurance industry

The new data (first 9 months of 1999)

combined ratio:	105.6 %
loss ratio:	73.0 %
return on equity (last 4 quarters):	7.2 %
net premium written – first 9 months of 1999:	$14,156,000,000
claims incurred:	$10,069,000,000
underwriting loss:	($607,000,000)
investment profit before gain:	$1,554,000,000
investment gain:	$322,000,000
net profit:	$895,000,000

The tail wags the dog, by Paul Kovacs

This year, industry earnings remain last year's disappointing results. Some key third quarter measures were marginally weaker from those in the first half of the year, with no widespread improvement yet.

Typically investment decisions are a relatively small and largely invisible part of the industry's performance, but not this year. Realized investment gains in the first nine months of the year were less than half the total for the same period one year ago. The $334 million drop in investment gains was large enough to more than offset moderate improvements elsewhere, and pushed industry earnings down by $74 million. The focus this year on investment gains is somewhat like the tail wagging the dog.

Almost all other industry performance measures have improved this year, but very modestly. The industry combined ratio has been near 105 most of the year, down from 107.6 last year. Claims are almost two percent lower, and earned premiums have edged forward by one half of a percent. Industry capitalization is solid, and some markets have strengthened during the year.

The key, however, is that industry earnings cannot be sustained at these levels. The return this year of steady and continuing advancement in equity markets does help establish part of the foundation for improvement, following the wild swings in the market one year ago. It is essential, however, to secure greater improvements in underwriting performance. Harder markets, particularly the larger markets, must be evident if earnings measures are to clearly move back up to reasonable rates again.

Time in the sun

Almost half of the insurers in Canada have recorded superior underwriting results at some point over the past twenty years, but few remain industry leaders every year. This is one more sign of aggressive competition in the industry.

The fifty largest insurers in 1979, 1983, 1988, 1993 and 1998 were studied. Forty-five percent of the companies were ranked in the top ten in terms of underwriting results in at least one year. This includes ten percent that recorded superior results most years. Fifty-five percent never had a year among the ten strongest performers.

The TRAC data have been ajusted for changes in the industry due to events like mergers. Accordingly, firms were followed through the twenty-year period. The number of changes were quite numerous.

The data consistently show strong correlation between superior underwriting results and earnings. The companies that are most effective in risk selection have lower claims costs and stronger earnings. This is evident for a single year and over a period of many years. Similar findings are evident in the Canadian results and those of the other major markets in the United States, Japan and Europe.

Superior performance, however, can be transient in highly competitive industries like insurance. People change firms, ideas are copied and innovations strengthen results for a relatively short period of time. The innovation or other advantage that a high-performing company might have had can be imitated by other companies. This has the effect of distributing the industry profits among more companies, thereby reducing the results of the company initially performed well to a level closer to the average.

The other side of this analysis is the observation that there are no insurers that are always among the very weakest performers. Every company had at least moderate underwriting results at some point over this period.

Large variations in results between insurers are always evident in this industry. The greatest differences are found in underwriting and earnings performance. There is very little variation in investment returns across the industry. Superior and weak earnings performance is typically reflected in the variation in underwriting and risk selection. The extent of variation has been remarkably stable over time.

The new data

Steady underwriting masks variability by line of business

Canadian property and casualty insurers' underwriting performance held steady in the third quarter of 1999, compared to the same three months of last year. Earned premiums and claims for the quarter rose almost in step, with earned premium up 1.4 percent, and claims up 2.5 percent. As a result, the quarterly loss ratio of 74.3 percent was only slightly changed from last year's 73.5 percent. Taking expenses into account, the third quarter combined ratio was 107.1 percent, virtually unchanged from 106.4 percent last year. The third quarter underwriting loss for 1999 was $218 million compared to 1988's loss of $263 million.

Despite the steady aggregate results, there is much variability in performance by line of business. Personal property markets are weakening across the country, with the exception of the Prairies where loss ratios are on decline. In contrast, commercial property markets are holding steady or improving across the country, except in Quebec. Auto results are similarly mixed with improving results in Quebec and the Prairies, while loss ratios continue to rise in Ontario and Atlantic Canada.

Investment earnings on par

At $613 million third quarter investment income is below last year's $708 million and only 70 percent of the record $887 million posted in 1997. This year's result, however, is in line with investment income and gains recorded throughout the decade. Throughout the 1990s, the average third quarter investment income has been $652 million.

Look inside to see the rewards

Stable, moderate earnings are a characteristic of Canada's insurance market. At the low point in the insurance cycle, like the current market, earnings fall near 7 percent ROE. At the high point, it is rare for industry earnings to exceed 15 percent.

There are a few industries in Canada that recorded positive earnings every year since the mid-1970s, when modern records began. P&C insurance is the only financial industry. Telecommunications, power generation and transmission, and cable television are some consistently profitable non-financial industries.

Periods of economic weakness have relatively little negative impact on the industry's premium income, and some expenses actually fall during a downturn. Indeed, the insurance cycle is typically quite distinct from the overall business cycle.

Insurers, however, also generally do not participate in the earnings windfall evident during periods of economic strength. Many industries record exceptional earnings during these boom years to help them survive the next downturn.

Beyond earnings, stability is also found in other industry measures. For example, insurers maintain a stable workforce relative to the hiring and layoff experience in other industries. Insurance spending on new technology and equipment is also relatively stable over time. In addition, industry capitalization is sound and steadily on the rise.

The greatest variation in the insurance market is within the industry, and not through the business cycle. This is quite distinct from other sectors where it is common for every firm to simultaneously experience very strong or very weak performance.

In insurance, some firms have poor results during a good year for the industry, while some insurers have strong results during a bad year for the industry. The difference can be quite large.

The main factor that makes insurance so distinct is intense competition. Insurers do follow their own business plan, rather than duplicate that of a market leader. Indeed, it is one of the few industries that really does not have clear market leaders and dominant producers. This may bring success, or perhaps underperformance, but the focus is consistently on serving customers and securing moderate earnings.

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Perspective - Analyse trimestrielle de la situation financière des assureurs de dommages du Canada

Chiffres les plus récents (neuf premiers mois de 1999)

ratio combiné :	105,6 %
ratio sinistres à primes :	73,0 %
rendement des capitaux propres (4 derniers trimestres) :	7,2 %
primes nettes souscrites - 9 premiers mois de 1999 :	14 156 000 000 $
sinistres réalisés :	10 069 000 000 $
perte de souscription :	(607 000 000 $)
bénéfice de placement avant gain :	1 554 000 000 $
gain de placement :	322 000 000 $
bénéfice net :	895 000 000 $

Les rôles inversés, par Paul Kovacs

Cette année, les revenus de l'industrie avoisinent les résultats décevants de l'an dernier. Au troisième trimestre, certains revenus de base ont été sensiblement inférieurs à ceux du premier semestre et l'on n'entrevoit pas encore d'amélioration généralisée.

Habituellement, les décisions d'investissement représentent une partie relativement faible et très peu visible du rendement de l'industrie. Mais pas cette année. Les revenus de placement réalisés au cours des neuf premiers mois de l'année n'ont pas dépassé la moitié des revenus de la même période l'an dernier. La chute de